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In the Supreme Court of the United States

OCTOBER TERM, 1997

NYNEX CORPORATION, ET AL., PETITIONERS

v.

DISCON, INCORPORATED

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AND THE FEDERAL TRADE COMMISSION AS AMICI CURIAE IN SUPPORT OF VACATING THE JUDGMENT

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QUESTIONS PRESENTED

1. Whether an agreement between a purchaser and a supplier to eliminate a competing supplier may be condemned as an unlawful group boycott in violation of Section 1 of the Sherman Act, 15 U.S.C. 1.

2. Whether a purchaser may conspire to monopolize in violation of Section 2 of the Sherman Act, 15 U.S.C. 2, when the purchaser agrees with a supplier to eliminate a competing supplier with the specific intent to assist the first supplier in its acquisition or maintenance of monopoly power.

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INTEREST OF THE UNITED STATES AND THE FEDERAL TRADE COMMISSION

The United States and the Federal Trade Commission have primary responsibility for enforcing the federal antitrust laws and thus have a substantial interest in ensuring that the Sherman Act is construed in a manner that advances, rather than impedes, its objectives. At this Court's invitation, the United States and the Federal Trade Commission filed a brief at the petition stage of this case.

STATEMENT

1. Respondent Discon, Incorporated (Discon), supplied "removal services," consisting of the salvage and disposal of obsolete telephone central office equipment, in the State of New York. Amend. Compl. ¶ 13 (J.A. 78). A principal user of removal services in the State was petitioner New York Telephone Company (NYT), a regulated subsidiary of petitioner NYNEX and the monopoly provider of local telephone exchange service throughout most of the State. *Id.* ¶¶ 2, 23, 29 (J.A. 76, 81, 83). Other users of removal services in the State included Rochester Telephone Company and AT&T, through its affiliate AT&T Communications. *Id.* ¶¶ 2, 23, 29, 53 (J.A. 76, 81, 83, 91). AT&T purchased removal services exclusively from its affiliate AT&T Technologies, the leading supplier of removal services in the State and a competitor of Discon in supplying removal services to NYT. *Id.* ¶¶ 26, 29 (J.A. 82-83). During the period at issue, NYT ordinarily purchased removal services through petitioner NYNEX Materiel Enterprises (MECo), a NYNEX subsidiary that served as a purchasing agent for NYNEX and its affiliates. *Id.* ¶¶ 24-27 (J.A. 82-83). Although the rates that NYT charged to local telephone users were regulated, the prices that MECo charged to NYT were not. *Id.* ¶¶ 27, 30 (J.A. 83-84).

According to Discon's complaint, from 1984 through at least 1986, petitioners and AT&T took advantage of that regulatory structure to implement a conspiracy designed to overcharge NYT's customers for local telephone service.[1] MECo purchased

[1] Because the court of appeals correctly treated NYNEX and its wholly owned subsidiaries, NYT and MECo, as a single antitrust entity in the circumstances presented by this case (see Pet. App. 8a-10a), we ascribe MECo's alleged conduct to NYNEX and NYT.

removal services from AT&T, allegedly at inflated prices. MECo allegedly passed these prices on to NYT, which submitted them to state regulators as a cost of providing local telephone service. Because the regulators set NYT's rates for local telephone services based on its cost of service, NYT recovered from its local telephone customers the amounts that it paid to MECo (and hence AT&T) for removal services. AT&T allegedly then paid MECo a secret year-end rebate that, in effect, reduced the prices that MECo paid for AT&T removal services below the levels that NYT disclosed to state regulators. Amend. Compl. ¶¶ 30-31, 59, 64-67, 110 (J.A. 83-84, 92-94, 112-113). Thus, as the court of appeals explained, petitioners allegedly "were able to generate increased revenues that were essentially derived from [NYT's] telephone monopoly" while avoiding "oversight from the state regulatory commission." Pet. App. 5a.

Because the conspiracy, as alleged in Discon's complaint, hinged on MECo's acceptance of inflated bids from AT&T and on the state regulators' assumption that the prices that NYT disclosed to them were legitimate, the conspiracy was at risk of being exposed if the regulators learned of lower bids submitted by competing lower-cost suppliers, particularly absent any satisfactory explanation as to why those suppliers had not been selected over AT&T. Discon alleged that it posed precisely such a threat because it refused to join the conspiracy, sought to sell removal services directly to NYT instead of

acting through MECo, and underbid AT&T's inflated bids. Amend. Compl. ¶¶ 40-45, 52 (J.A. 87-88, 90).[2]

According to Discon's complaint, in order to eliminate the threat posed by Discon, petitioners and AT&T conspired to exclude Discon from the market. Amend. Compl. ¶¶ 2-3, 32-33 (J.A. 75-77, 84-86). Petitioners, among other things, granted contracts to AT&T even when Discon, a lower-cost supplier, submitted substantially lower bids. *Id.* ¶ 34 (J.A. 86). Petitioners also decertified Discon as an approved supplier for NYNEX affiliates and, in concert with AT&T, disseminated false information designed to provide state regulators with facially legitimate (but wholly pretextual) reasons for Discon's decertification. *Id.* ¶¶ 33, 47, 50, 53-56 (J.A. 84-86, 89-91). Barred from supplying the major users of removal services in New York, Discon went out of business. *Id.* ¶¶ 108, 113 (J.A. 112-113). The result, according to the complaint, was that AT&T "perpetuated its monopoly

[2] According to Discon's complaint, the scheme ultimately was uncovered and, in 1992, state regulators "prohibited most transactions between NYT and unregulated affiliates." Amend. Compl. ¶ 16 (J.A. 79). The FCC also initiated enforcement proceedings against NYT for apparent violation of FCC rules in connection with "unreasonable markups and overcharges by MECO on sales of equipment, supplies, and services to NYT," which, "in turn, recorded these artificially inflated costs on [its] regulated books of account, enabling [it] to recover these costs from ratepayers through the ratemaking process." *In re New York Tel. Co.*, 5 FCC Rcd 866 (1990). NYT subsequently entered into a consent decree; without admitting liability, NYT agreed to refund more than $35 million for "unreasonable rates reflecting improper capital costs and expense charges." *In re New York Telephone Co.*, 5 FCC Rcd 5892, 5893 (1990) (internal quotation marks omitted).

over the supply of removal services to NYT." *Id.* ¶ 26 (J.A. 83).

2. Discon brought suit against petitioners in May 1990 and, following dismissal of its original complaint, filed an amended complaint alleging, among other things, that the above-described conduct violated Sections 1 and 2 of the Sherman Act, 15 U.S.C. 1, 2. Discon's complaint characterized MECo as a separate antitrust entity that competed with AT&T and Discon in supplying removal services to NYT. Amend. Compl. ¶¶ 2, 29 (J.A. 75-76, 83). Accordingly, in responding to petitioners' motion to dismiss for failure to state a claim, Discon principally argued that petitioners and AT&T had entered into an unlawful horizontal agreement designed to secure monopoly power in the removal services markets. In the alternative, Discon maintained that petitioners and AT&T had entered into a vertical price-fixing scheme that was per se unlawful under Section 1. Discon only briefly asserted that the alleged scheme also violated Section 1 under a rule-of-reason theory by "eliminat[ing] competition in the market for the provision of removal services."[3] Petitioners essentially ignored Discon's rule-of-reason theory in seeking dismissal of the complaint.[4]

The district court granted petitioners' motion to dismiss the complaint. The court refused to characterize the alleged conspiracy as horizontal, concluding that MECo could not properly be viewed as a supplier of removal services. Pet. App. 28a-29a. The court held that any other Section 1 theory failed

[3] Opposition to Motion to Dismiss 20 (Mar. 1, 1993).

[4] See Reply Memorandum in Support of Motion to Dismiss 4-10 (Mar. 22, 1993).

because Discon had not adequately alleged a conspiracy. *Id.* at 30a-31a. The court also dismissed Discon's claims under Section 2 for monopolization and attempted monopolization, concluding that petitioners neither competed nor sought to obtain monopoly power in the removal services market. *Id.* at 32a-36a. The court rejected Discon's Section 2 conspiracy-to-monopolize claim both for that reason and for failure adequately to allege a conspiracy. *Id.* at 37a-38a.

3. The court of appeals affirmed in part, reversed in part, and remanded for further proceedings. Pet. App. 1a-15a, 20a. With respect to the Section 1 claim, the court of appeals agreed with the district court that MECo could not properly be characterized as a supplier of removal services and, therefore, that "Discon cannot succeed on its theory of a classic horizontal restraint of trade," the theory on which Discon had "primarily" relied. *Id.* at 8a, 10a. The court nonetheless reinstated Discon's Section 1 claim on the ground that "Discon may be able to prevail under a different legal theory." *Id.* at 10a; see also *id.* at 7a ("the complaint states a cause of action under Section One of the Sherman Act, though under a different legal theory than the one articulated by Discon").

Invoking *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), the court concluded that an agreement between vertically situated actors, including one between a single supplier and a single purchaser, could be characterized as an unlawful "group boycott" if the agreement had "a horizontal market impact." Pet. App. 11a. The court recognized that "*in general* two-firm vertical combinations will be scrutinized as exclusive distributorship controversies, rather than as group boycotts." *Id.* at 12a (citing *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717 (1988)). The court purported to distinguish a "per se" unlawful "group boycott" from a vertical restraint analyzed under the rule of reason based on whether the restraint "has no purpose except stifling competition." *Id.* at 13a (internal quotation marks omitted).

Because Discon alleged that "the intent and effect of [petitioners'] choosing AT&T Technologies over Discon was entirely anti-competitive," the court of appeals concluded that Discon "alleged a cause of action under, at least, the rule of reason." Pet. App. 12a-13a. The court did not, however, identify any particular market affected by the alleged conspiracy between AT&T and petitioners to exclude Discon. Nor did the court identify any particular anticompetitive effect of that alleged conspiracy.[5] The court also concluded that Discon might have stated a claim under "the *per se* rule applied to group boycotts in *Klor's*" if Discon substantiated its allegations that the restraint "ha[d] no purpose except stifling

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[5] The court of appeals noted (Pet. App. 12a) that "overcharg[ing] captive rate-paying customers" was an object of the conspiracy. But the court did not, as petitioners now assert (Pet. Br. 17), clearly identify such overcharges as the *anticompetitive* effect stemming from Discon's elimination. The court's failure to focus on that issue is hardly surprising in light of the scant attention that the parties devoted to it in their briefs. Compare Discon C.A. Br. 20 (conclusorily asserting that the conspiracy "violated the rule of reason" because it "harmed competition in the central office removal market in New York with no offsetting benefit" and because it "was intended to and led to [petitioners' and AT&T's] sharing of monopolistic prices") with Appellee C.A. Br. 19-20 (arguing that the decision to use one supplier instead of another cannot violate the Sherman Act).

competition." *Id.* at 13a (internal quotation marks omitted).[6]

With respect to the Section 2 claims, the court of appeals, while affirming the dismissal of the monopolization and attempted monopolization claims, reinstated the conspiracy-to-monopolize claim. Pet. App. 14a. The court reasoned that "[a] defendant may be liable for conspiracy to monopolize where it agrees with another firm to assist that firm in its attempt to monopolize the relevant market." *Ibid.* The court determined that Discon had "sufficiently allege[d]" that petitioners "conspired with AT&T Technologies and performed overt acts" with the specific "inten[t] to assist AT&T Technologies in its monopolization of the market for removal services." *Id.* at 15a.

SUMMARY OF ARGUMENT

The court of appeals concluded that an agreement between a firm and its supplier to exclude a competing supplier is a "group boycott," and "per se" unlawful under Section 1 of the Sherman Act, if the agreement is found, after a case-specific inquiry, to produce solely anticompetitive effects. Under this Court's decisions, however, only certain concerted refusals to deal by competitors warrant a categorical and conclusive presumption of predominantly anticompetitive effects and thus may be invalidated as group boycotts. See *Northwest Wholesale Stationers, Inc.* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284, 294 (1985).

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[6] Reversing the district court, the court of appeals also held that the complaint adequately alleged a vertical conspiracy between petitioners and AT&T. Pet. App. 7a n.3. The court, however, agreed with the district court that the complaint failed to allege a per se unlawful vertical resale price maintenance agreement. *Id.* at 10a n.5.

The conspiracy alleged here does not fall into any of the categories that this Court has previously denominated as per se illegal and, because vertical agreements to deal with one supplier often serve procompetitive purposes even if they disadvantage a rival supplier, per se treatment is inappropriate regardless of the label affixed to the arrangement. See *State Oil Co.* v. *Khan*, 118 S. Ct. 275, 279 (1997).

The court of appeals correctly concluded, however, that two firms may conspire to monopolize a market, in violation of Section 2 of the Sherman Act, even if only one of the firms competes in that market, as long as both specifically intend that one firm obtain monopoly power and agree to engage in conduct that is directed to that end and that lacks any legitimate business justification. Petitioners' contention that the Section 2 claim should have been dismissed because of asserted pleading deficiencies in the complaint is not properly before this Court. And petitioners' argument that the claim should have been dismissed because it is "implausible" that petitioners specifically intended to assist AT&T in obtaining monopoly power is incorrect. Regulation—and, in particular, schemes designed to avoid it—may create an incentive for a monopolist to engage in anticompetitive conduct that it would not engage in absent regulation. The court of appeals found in the complaint allegations that petitioners had an incentive to help AT&T obtain monopoly power because competing suppliers of removal services jeopardized petitioners' scheme to evade regulation. It is not "inherently implausible" in such circumstances for the benefits to petitioners from regulatory evasion to outweigh the costs, if any, to petitioners if AT&T obtained monopoly power.

We believe that the appropriate disposition of this case is to vacate the judgment of the court of appeals and to remand the case for further proceedings on both the rule-of-reason claim under Section 1 and the conspiracy-to-monopolize claim under Section 2. The court of appeals determined that the complaint alleged a Section 1 claim under the rule of reason but did not elaborate on the nature of that claim, which the court recognized (Pet. App. 7a) to be based on "a different legal theory than the one articulated by Discon." Although petitioners raise in this Court a number of objections to the court of appeals' rule-of-reason holding, those contentions neither were raised below nor are fairly included within the question presented. Because the court of appeals did not have an opportunity to consider those objections and misapprehended the law relating to group boycotts, we believe that the court should be directed to give further consideration to whether the complaint states a claim under the rule of reason. The court of appeals also reinstated the Section 2 claim based on a theory that Discon had not clearly pressed below. Because the court did not have an opportunity to consider petitioners' current objections to that theory, and because the court was not entirely clear as to whether Discon adequately alleged that petitioners conspired with the specific intent to secure monopoly power for AT&T, the court should also be directed to give further consideration to whether Discon adequately alleged a conspiracy to monopolize.

ARGUMENT

I. THE COURT OF APPEALS ERRONEOUSLY CONCLUDED THAT A VERTICAL AGREEMENT TO EXCLUDE A COMPETING SUPPLIER MAY BE A PER SE UNLAWFUL GROUP BOYCOTT

The court of appeals erred in concluding (Pet. App. 12a-13a) that the alleged conspiracy to "discriminate in favor of [AT&T] over [Discon]" could be invalidated as a per se unlawful group boycott.

1. "Although the Sherman Act, by its terms, prohibits every agreement 'in restraint of trade,' this Court has long recognized that Congress intended to outlaw only unreasonable restraints." *State Oil Co.* v. *Khan*, 118 S. Ct. 275, 279 (1997). "Some types of restraints, however, have such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit, that they are deemed unlawful *per se*." *Ibid.* Application of the per se rule to such restraints serves the salutary purposes of "provid[ing] guidance to the business community" and "minimiz[ing] the burdens on litigants and the judicial system of the more complex rule-of-reason trials." *Continental T. V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 50 n.16 (1977).

This Court has long held that certain concerted refusals to deal are "so likely to restrict competition without any offsetting efficiency gains that they should be condemned as *per* se violations of § 1 of the Sherman Act." *Northwest Wholesale Stationers, Inc.* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284, 290 (1985). And the Court has repeatedly listed "[g]roup boycotts" among the classes of concerted

refusals to deal that "merit *per se* invalidation." *Id.* at 293 (citing cases). Conduct that is properly classified as a "group boycott" is thus "conclusively presumed to be anticompetitive." *Id.* at 290, 294-295; *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 458 (1986) (conduct properly denominated a "boycott" is subject to "the *per se* rule"). See also, *e.g.*, *Arizona* v. *Maricopa County Med. Soc'y*, 457 U.S. 332, 344 n.15 (1982) ("group boycotts" are "[a]mong the practices which the courts have heretofore deemed to be unlawful in and of themselves") (quoting *Northern Pac. Ry.* v. *United States*, 356 U.S. 1, 5 (1958)); *United States* v. *General Motors Corp.*, 384 U.S. 127, 145-146 (1966) ("[g]roup boycotts" are "among those classes of restraints which from their nature or character [are] unduly restrictive" and thus "are conclusively presumed to be unreasonable") (internal quotation marks omitted); *Summit Health, Ltd.* v. *Pinhas*, 500 U.S. 322, 337 (1991) (Scalia, J., dissenting) ("group boycotts are *per se* violations").

Because those restraints that are denominated "group boycott[s]" violate the Sherman Act "without regard to the reasonableness of the conduct in the circumstances," *General Motors*, 384 U.S. at 145-146, this Court has mandated that "[s]ome care" be exercised in "defining the [types] of concerted refusals to deal" that "fall within the forbidden category." *Northwest Wholesale Stationers*, 472 U.S. at 294; *Indiana Fed'n of Dentists*, 476 U.S. at 458 ("the category of restraints classed as group boycotts is not to be expanded indiscriminately"). The category does not encompass "every cooperative activity involving a restraint or exclusion." *Northwest Wholesale Stationers*, 472 U.S. at 295. It is restricted to "form[s] of concerted activity" that are "characteristically likely

to result in predominately anticompetitive effects." *Ibid.*; accord *Indiana Fed'n of Dentists*, 476 U.S. at 458. Indeed, the Court has applied the "group boycott" label only to agreements among competitors that restricted their freedom to deal with third parties. See, *e.g.*, *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717, 734 & n.5 (1988) ("group boycotts" are "agreements among competitors to refuse to deal" and "involve[] horizontal combinations") (quoting Robert Bork, *The Antitrust Paradox* 330 (1978)); *Indiana Fed'n of Dentists*, 476 U.S. at 458 (per se unlawful group boycott category "has generally been limited to cases in which firms with market power boycott suppliers or customers in order to discourage them from doing business with a competitor"); *Northwest Wholesale Stationers*, 472 U.S. at 294 (citing cases); cf. *FTC* v. *Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 434 (1990) (describing "boycotts" as "horizontal arrangement[s] among competitors").[7]

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[7] Petitioners suggest (Pet. Br. 14-17 & n.14) that the Court used the terms "group boycott" and "concerted refusal to deal" interchangeably in *Northwest Wholesale Stationers* and, therefore, that group boycotts may be evaluated under "either a *per se* or a rule-of-reason standard" (*id.* at 16, 19 & n.16). As noted in the text, however, the Court made clear in *Northwest Wholesale Stationers* that only certain concerted refusals to deal merit per se treatment and that only those restraints properly are denominated as "group boycotts." See 472 U.S. at 294-295. Thus, as petitioners acknowledge (Pet. Br. 17 n.14), although the district court in that case held that the arrangement at issue, "[e]ven if it is a group boycott," was subject to rule-of-reason analysis, this Court was more precise in its terminology, approving the district court's recognition that "not all *concerted refusals to deal* should be accorded *per se*

Confining the "group boycott" category to conspiracies that include some horizontal element—*i.e.*, involving "[r]estraints imposed by agreement between competitors," *Business Elecs.*, 485 U.S. at 730—reflects the justification for the per se/rule-of-reason distinction. In contrast to certain horizontal restraints, vertical nonprice restraints are often procompetitive and, therefore, are presumptively evaluated under the rule of reason. See, *e.g.*, *id.* at 724-726; *GTE Sylvania*, 433 U.S. at 58-59; cf. *State Oil*, 118 S. Ct. at 281 (discussing such restraints). Although such arrangements can cause anticompetitive effects in certain circumstances, categorical condemnation is generally unwarranted.[8] Thus, in *Business Electronics*, this Court refused to characterize an agreement between a manufacturer and a dealer to terminate a price-cutting dealer as a per se unlawful group boycott. See 485 U.S. at 726-727, 734. Although the dissent argued that the "boycott" label was appropriate because the particular facts of the case showed the agreement to be unrelated to any procompetitive purpose, see *id.* at 744-748 (Stevens, J., dissenting), the Court refused to apply the per se rule because the *type* of restraint at issue had not been shown to be one that "almost always tends to restrict competition and reduce output." *Id.* at 726-727.

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treatment." *Northwest Wholesale Stationers*, 472 U.S. at 297 & n.9 (internal quotation marks omitted; emphasis added).

[8] The exception consists of certain tying arrangements, which are subject to per se invalidation only if the seller of the tying product enjoys market power. See *Eastman Kodak Co.* v. *Image Technical Servs., Inc.*, 504 U.S. 451, 461-462 (1992); *Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S. 2, 12-15 (1984).

2. Under this Court's decisions, the restraint at issue here—a vertical agreement between a purchaser and a supplier to exclude another supplier—cannot properly be termed a "group boycott." As the court of appeals acknowledged (Pet. App. 12a), "[i]n the vast majority of cases, the decision to discriminate in favor of one supplier over another will have a pro-competitive intent and effect." That correct observation precludes categorical condemnation of such arrangements. Indeed, virtually any requirements contract could be characterized as a "two-firm vertical" agreement "to discriminate in favor of one supplier over another." *Ibid.* Yet, such agreements are considered generally to enhance efficiency and thus are subject to evaluation under the rule of reason. See *Tampa Elec. Co.* v. *Nashville Coal Co.*, 365 U.S. 320, 334 (1961); *Standard Oil Co.* v. *United States*, 337 U.S. 293, 306-307 (1949); *Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S. 2, 45 (1984) (O'Connor, J., concurring); *U.S. Healthcare, Inc.* v. *Healthsource, Inc.*, 986 F.2d 589, 595 (1st Cir. 1993) (Boudin, J.); *Barry Wright Corp.* v. *ITT Grinnell Corp.*, 724 F.2d 227, 236-237 (1st Cir. 1983) (Breyer, J.) (citing cases from other circuits).

The court of appeals reached a contrary conclusion in this case because it used the terms "group boycott" and "per se" in a manner that finds no support in this Court's decisions. The court appeared to use "group boycott" not to refer to a class of restraint that warrants categorical condemnation because of its inherently anticompetitive character, but rather to denote a vertical agreement to exclude a supplier when, on the facts of a particular case, the agreement is found to have solely anticompetitive effects. And the court denominated the outcome of that case-specific exami-

nation "*per se* invalidation" even though the court required the sort of detailed inquiry into anticompetitive effects and procompetitive justifications that the per se rule is designed to avoid. See, *e.g.*, *Northwest Wholesale Stationers*, 472 U.S. at 289; *Maricopa County Medical Soc'y*, 457 U.S. at 343-344; *GTE Sylvania*, 433 U.S. at 50 & n.16. In *Business Electronics*, however, this Court declined the dissent's suggestion that an agreement between a producer and a dealer could be deemed a "group boycott" and per se invalid if, based on an examination of "the precise character of the agreement" at issue, that agreement was found to be "simply [a] naked restraint[] on price competition" with no procompetitive justification. See 485 U.S. at 726-730; *id.* at 742-748 (Stevens, J., dissenting).

This Court's decision in *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), which the court of appeals relied on to derive its understanding of "the *per se* rule applied to group boycotts" (Pet. App. 13a), does not support the decision here. *Klor's* turned not on a case-specific assessment of anticompetitive effects and procompetitive justifications, but rather on a categorical evaluation of the defendants' conduct. See 359 U.S. at 212-213; see also *General Motors*, 384 U.S. at 145-146 (observing that the "group boycott" in *Klor's* was held to violate the antitrust laws "without regard to the reasonableness of the conduct in the circumstances"); *Radiant Burners, Inc.* v. *Peoples Gas Light & Coke Co.*, 364 U.S. 656, 659 (1961) (per curiam). Indeed, the *Klor's* Court expressly rejected the notion that the defendants' conduct did not implicate the Sherman Act "because the victim is just one merchant whose business is so small that his destruction makes little difference to the economy."

359 U.S. at 213. Moreover, although the court of appeals described the agreements among the defendants in *Klor's* as "essentially vertical in nature" (Pet. App. 11a), the *Klor's* Court emphasized that the case involved not a "manufacturer and a dealer agreeing to an exclusive distributorship" but rather "a wide combination consisting of manufacturers, distributors and a retailer," 359 U.S. at 212-213. This Court has since described the case as standing for the principle that "any agreement by a group of competitors to boycott a particular buyer or group of buyers is illegal *per se*." *FMC* v. *Aktiebolaget Svenska Amerika Linien*, 390 U.S. 238, 250 (1968); accord *General Motors*, 384 U.S. at 146. And in *Business Electronics*, the Court made clear that *Klor's* rule of per se illegality was tied to the existence there of a "horizontal combination[]." 485 U.S. at 734.

Accordingly, the court of appeals erred in concluding that the vertical agreement between petitioners and AT&T, if shown to "ha[ve] no purpose except stifling competition" in the particular circumstances of this case (Pet. App. 13a (internal quotation marks omitted)), could be invalidated as a per se unlawful "group boycott." Discon's allegations of a Section 1 violation should be judged solely under the rule of reason.

3. Because the question presented with respect to Section 1 is limited to whether the court of appeals erred in characterizing the agreement that Discon alleged as an illegal "group boycott" (Pet. i; Pet. Br. i),[9] there is no occasion for this Court to address

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[9] Similarly, in the portion of the petition addressing the Section 1 claim, petitioners focused on urging the Court to review the Second Circuit's "[e]xten[sion] of the [g]roup [b]oycott [r]ule

petitioners' arguments (Pet. Br. 22-39) that Discon failed to state a claim not only under the per se rule but also under the rule of reason. The rule-of-reason question is analytically distinct from, and not "fairly included" within, the question presented. *Izumi Seimitsu Kogyo Kabushiki Kaisha* v. *U.S. Philips Corp.*, 510 U.S. 27, 30-32 & n.5 (1993) (per curiam) (explaining that "'[o]nly the questions set forth in the petition, or fairly included therein, will be considered by the Court'" and that the mere "fact that the parties devoted a portion of their merits briefs" to an issue "does not bring that question properly before" the Court) (quoting Sup. Ct. R. 14.1(a)); accord *Pennsylvania Dep't of Corrections* v. *Yeskey*, No. 97-634 (June 15, 1998), slip op. 6; *Cass County* v. *Leech Lake Band of Chippewa Indians*, No. 97-174 (June 8, 1998), slip op. 11 n.5. A question, such as the rule-of-reason question here, that "is merely complementary or related to the question presented in the petition for certiorari is not fairly included therein." *Izumi Seimitsu*, 510 U.S. at 31-32 (internal quotation marks omitted).

Moreover, petitioners' arguments not only are beyond the questions presented, but also turn on issues

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of *Klor's*" (Pet. 7), a decision which, as noted in the text, involved a per se unlawful group boycott. See also, *e.g.*, *id.* at 9 (criticizing the court of appeals' "reach[ing] out to apply *Klor's*"); *id.* at 10 (arguing that "the holding of the court below that the group boycott doctrine of *Klor's* can be extended to two-firm supplier-purchaser situations has created a sharp conflict among circuits"); *id.* at 12 (criticizing the court of appeals' "extension of the group boycott rule of *Klor's* to vertical non-price agreements"); *id.* at 13 (urging review of court of appeals' holding on Section 1 "insofar as it creates a new rule of two-firm supplier-purchaser group boycott").

that were neither raised nor specifically addressed below. Those include the admittedly "novel" (Pet. Br. 36) question whether a supplier such as Discon can prevail on a rule-of-reason claim that is based on a regulatory evasion scheme.[10] As the United States previously noted (U.S. Pet. Br. 18-20), the Court would be required to address petitioners' rule-of-reason claim without the benefit of either a developed factual record or any analysis of the pertinent issues by the lower courts. Such circumstances counsel for "faithful application" of Rule 14.1(a). *Izumi Seimitsu*, 510 U.S. at 34; cf. *Walker Process Equip., Inc.* v. *Food Mach. & Chem. Corp.*, 382 U.S. 172, 178 (1965) (concluding that "even though the *per se* claim fails at this stage of litigation," the case "should be remanded for [the plaintiff] to clarify the asserted violations * * * and to offer proof thereon," in part because of "the novelty of the claim asserted and the paucity of guidelines available in the decided cases").

4. We believe that the court of appeals' judgment reinstating the Section 1 claim should be vacated and

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[10] As petitioners recognize (Pet. Br. 20-22), there is no need to address that question in order to conclude that the scheme that Discon alleged is not unlawful per se. Whether or not a scheme to exclude a supplier for the purpose and with the effect of facilitating the evasion of regulation violates the antitrust laws in some circumstances (cf. U.S. Pet. Br. 7-12), the courts obviously lack sufficient experience with such "novel" (Pet. Br. 36) claims to warrant the creation of a new category of per se illegality. See *State Oil*, 118 S. Ct. at 279 ("*Per se* treatment is appropriate '[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it.'") (quoting *Maricopa County Med. Soc'y*, 457 U.S. at 344).

remanded for further consideration by the court of appeals.[11] The court of appeals stated that the complaint was sufficient to "allege[] a cause of action under * * * the rule of reason" (Pet. App. 13a), but it did not specify the nature of the claim, which the court recognized (Pet. App. 7a) to be based on "a different legal theory than the one articulated by Discon" on appeal. The court did not identify the market that allegedly was affected or explain the nature of the anticompetitive effects that allegedly occurred. Nor did the parties' arguments before that court focus on those issues. For those reasons, and because the sufficiency of the complaint to state a claim under the rule of reason is not fairly included within the questions presented, we believe that a remand is appropriate to allow the court of appeals to address the objections to a rule-of-reason claim that petitioners now raise. See *State Oil*, 118 S. Ct. at 285 (remanding the Section 1 claim for further consideration under the rule of reason following the Court's rejection of a per se theory and despite the court of appeals' prior conclusion that "if the rule of reason is applicable, [the plaintiff] loses") (internal quotation marks omitted).[12]

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[11] Although petitioners now urge otherwise (Pet. Br. 15, 39, 43), they suggested that very disposition in seeking certiorari. See Pet. Supp. Br. 2.

[12] If the complaint sufficiently alleges a conspiracy to monopolize under Section 2, that conspiracy would also constitute an unreasonable agreement in restraint of trade under Section 1, and thus provide a basis for sustaining the judgment with respect to Section 1. See, *e.g.*, 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 809, at 370 (1996). However, for the same reasons the Court should vacate and remand the judgment with respect to the Section 2 claim, see

II. AN AGREEMENT BETWEEN A PURCHASER AND A SUPPLIER TO EXCLUDE A COMPETING SUPPLIER CAN CONSTITUTE AN UNLAWFUL CONSPIRACY TO MONOPOLIZE WHEN THE PARTIES SPECIFICALLY INTEND THE CONSPIRING SUPPLIER TO MONOPOLIZE THE MARKET

The petition presents the second question (Pet. i; Pet. Br. i) whether a vertical agreement between a supplier and a purchaser that does not involve price restraints may be characterized as a conspiracy to monopolize under Section 2 of the Sherman Act. The court of appeals implicitly answered that question in the affirmative. It concluded (Pet. App. 14a-15a) that Discon's complaint stated a conspiracy-to-monopolize claim because it alleged that petitioners conspired with AT&T to eliminate Discon with the specific intent to secure monopoly power for AT&T in the relevant removal services markets. The court of appeals' conclusion that such allegations state a claim under Section 2 is correct.

1. Section 2 proscribes "combin[ations] or conspir[acies] * * * to monopolize any part of the trade or commerce." 15 U.S.C. 2. The gravamen of such an offense is a conspiracy entered into by two or more actors sharing the specific intent to monopolize a market, *i.e.*, an intent to create or maintain monopoly power through improper means. See *United States Steel Corp.* v. *Fortner Enters., Inc.*, 429 U.S. 610, 612 n.1 (1977); see also *e.g.*, *Northeastern Tel. Co.* v.

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pp. 28-29, *infra*, the Court should leave for the court of appeals to determine on remand whether the Section 1 claim should proceed on the ground that the complaint adequately alleges a conspiracy to monopolize.

American Tel. & Tel. Co., 651 F.2d 76, 85 (2d Cir. 1981), cert. denied, 455 U.S. 943 (1982). The court of appeals read the complaint to allege those elements here: that petitioners conspired with AT&T to eliminate Discon from the removal services market, with the specific intent to secure monopoly power for AT&T in that market, by engaging in a course of conduct that lacked any efficiency justification. See Pet. App. 12a, 14a-15a.

To be sure, petitioners were not sellers in the alleged removal services markets and, therefore, did not seek to acquire monopoly power for themselves in those markets. But neither the text of the Sherman Act nor the procompetitive policy that it embodies suggests that a conspiracy designed to secure monopoly power for one of two conspirators is beyond the scope of Section 2 merely because the other conspirator does not compete in the market in which monopoly power is sought. See *Perington Wholesale, Inc.* v. *Burger King Corp.*, 631 F.2d 1369, 1377 (10th Cir. 1979) (concluding that "traders oriented vertically to each other can be found in violation of section 2 by conspiring to monopolize one horizontal market intersecting the vertical arrangement"). Section 2 proscribes conspiracies designed to achieve a particular result that is harmful to consumers: the creation or maintenance of monopoly power. See *American Tobacco Co.* v. *United States*, 328 U.S. 781, 788-789 (1946). Such competitive harm would befall consumers, "whose interests the statute was especially intended to serve," *Jefferson Parish*, 466 U.S. at 15, regardless of whether such power is shared by both of the conspirators or enjoyed by only one of them.

AT&T's acquisition of monopoly power over removal services plausibly would inflict such consumer

injury here. Discon's complaint alleges that the State of New York is a relevant removal services market and identifies at least one purchaser of removal services in that market other than the conspirators, Rochester Telephone Company. Amend. Compl. ¶ 53 (J.A. 91). If, as the Second Circuit appeared to read the complaint, the conspiracy to exclude Discon was designed to secure monopoly power for AT&T in that market, the success of the conspiracy would have eliminated competition in the market that benefited other purchasers of removal services, such as Rochester Telephone.[13]

2. Petitioners do not appear to dispute this analysis. See Pet. Br. 37, 42. They nonetheless contend that this Court should order the dismissal of the Section 2 claim on either of two other grounds: *first*, that the court of appeals misread Discon's complaint in finding that it sufficiently alleged a conspiracy to assist AT&T to monopolize the market for removal services (Pet. App. 15a), because Discon alleged harm only to itself and not to competition generally in the removal services market (Pet. Br. 37-38) and because Discon alleged, and argued below, that the consipiracy was designed to obtain monopoly power not for AT&T but for petitioners (*id.* at 40-41); and, *second*, that the court of appeals should have applied a heightened pleading standard because any claim that petitioners conspired to impose a monopoly on themselves is "implausible" (*id.* at 38-39, 42).

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[13] There is accordingly no need to consider whether the complaint would allege a Section 2 violation if the removal services market were limited to the narrower, NYT-only market that Discon also averred.

Those issues are not properly before this Court. Petitioners sought, and this Court granted, certiorari on the question whether a vertical non-price agreement between "a [p]urchaser" and its "[s]upplier" could "be characterized as a conspiracy to monopolize." Pet i; Pet. Br. i. In the portion of the petition discussing that question, petitioners simply argued, in general terms, that "a buyer's choice of one supplier rather than another" should never be viewed as a conspiracy to monopolize, even "where the result is the acquisition of monopoly power." Pet. 16.[14] Petitioners did not seek review of the court of appeals' reading of the complaint as alleging that petitioners specifically intended to assist AT&T in monopolizing the removal services market. Petitioners likewise did not seek review of the pleading standard applied by the court of appeals to Discon's conspiracy-to-monopolize claim.

Because the question presented is limited to whether a vertical agreement between a purchaser and supplier *ever* can be characterized as a conspiracy to monopolize, petitioners' various objections to the court of appeals' reading of the complaint are not "fairly included," Sup. Ct. Rule 14.1(a), within the question presented. Nor does the question presented

[14] See also Pet. 14-15 (challenging the court of appeals' "assum[ption]" that a "theory of conspiracy to monopolize is applicable where a purchaser agrees to buy from one supplier (the alleged would-be monopolist) rather than another, and where the purchaser's role in the alleged conspiracy to monopolize consists solely of favoring the alleged would-be monopolist as a supplier of the purchaser's needs"); Pet. Reply Br. 3 ("[R]espondent cites no case which has held that a buyer's choice of one supplier over another may be a conspiracy to monopolize.").

fairly encompass petitioners' contention, raised for the first time in their merits brief, that a heightened pleading standard should apply because allegations that NYNEX intended to confer monopoly power on AT&T are implausible. Petitioners should not be permitted to interject into the case new issues, many of them factbound, that are not fairly within the scope of the questions on which this Court granted certiorari. See *Izumi Seimitsu*, 510 U.S. at 30-34 (explaining that "faithful application of Rule 14.1(a)" furthers the Court's policy of "strongly 'disapprov[ing] the practice of smuggling additional questions into a case after we grant certiorari'") (quoting *Irvine* v. *California*, 347 U.S. 128, 129 (1954) (per curiam)).

3. It is arguable that the question presented does fairly include petitioners' contention that dismissal is warranted on the ground that "the theory that NYNEX conspired with the specific intent to subject itself, as buyer, to the monopoly power of AT&T is intrinsically implausible." Pet. Br. 42; see also *id.* at 38; Pet. Supp. Br. 10. Petitioners' "implausibility" argument, while principally offered in support of the heightened pleading standard discussed above, may also be read as suggesting that courts should reject, as a matter of law, *any* claim that a purchaser conspired with its supplier with the specific intent to facilitate the supplier's acquisition of monopoly power, *i.e.*, that such conduct cannot properly "be characterized as a conspiracy to monopolize." Pet. i; Pet. Br. ii. Even if a claim could properly be dismissed when otherwise sufficient allegations are "implausible," however, dismissal is not warranted here.

As petitioners point out (Pet. Br. 38-39), "the rational monopolist will usually want his input markets to be competitive, for competition usually will mini-

mize the costs that he has to pay for his inputs." *Olympia Equip. Leasing Co.* v. *Western Union Tel. Co.*, 797 F.2d 370, 374 (7th Cir. 1986) (Posner, J.), cert. denied, 480 U.S. 934 (1987); see also *Car Carriers, Inc.* v. *Ford Motor Co.*, 745 F.2d 1101 (7th Cir. 1984), cert. denied, 470 U.S. 1054 (1985). "There are, however, special circumstances in which a rational monopolist may want to restrict competition in an input market; as it happens, one of those circumstances is where the monopolist's rates are regulated." *Olympia*, 797 F.2d at 374. For instance, a monopolist subject to rate regulation "may have an incentive to project its monopoly into related but unregulated markets" in order, for example, to "smuggle" some of its profits in the regulated market, which "regulators would otherwise force it to pass on to the ratepayers," into the rates that it charges in the unregulated market. *Ibid*; see generally 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 787, at 282-285 (1996).

A regulated monopolist likewise might vertically integrate into an input market, sell the input to itself at a supracompetitive price, and recover the entire price from captive ratepayers. If other firms in the market are selling the input at a lower price, however, regulators may discover that the monopolist's vertical integration, rather than serving exclusively procompetitive ends, is designed to evade rate regulation and obtain monopoly rents. Thus, the monopolist might have an incentive to eliminate other suppliers—indeed, to acquire a second monopoly in the input market—in order to suppress the threat to its regulatory evasion posed by competing suppliers. Cf. *Olympia*, 797 F.2d at 374.

Similarly, under the allegations of Discon's complaint as construed by the court of appeals (see Pet. App. 14a-15a), it is not "inherently implausible" (Pet. Br. 39) that petitioners had an incentive to eliminate competition among suppliers of removal services. The alleged agreement between petitioners and AT&T to inflate the price of removal services and to share the resulting profits between themselves would have served as a substitute for the sort of "straightforward monopolistic" price increase that regulation prevented.[15] And such a scheme could have been jeopardized if regulators became aware of the competing bids of Discon and any other suppliers of removal services. The eliminiation of such competitors, as well as the assertion of wholly pretextual reasons for refusing to deal with them, could thus serve to conceal the scheme.

In arguing that "[t]he alleged profit-making mechanism of regulatory evasion in no way depended on or implied" the creation of monopoly power in the removal services market (Pet. Br. 38), petitioners overlook the nature of the threat that competing suppliers, such as Discon, allegedly posed to the regulatory evasion scheme. It it both plausible and consistent with the complaint, as the court of appeals read it, for petitioners to have concluded that the scheme could be concealed from regulators only by the elimination of competing suppliers. The immediate gains to petitioners from the profitable regulatory evasion scheme could, at least conceivably, have outweighed the risk of future loss from AT&T's acquisition of monopoly power. The regulatory structure allowed petitioners to pass on to ratepayers any monopoly price that AT&T charged for removal services. Accordingly, if

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[15] Thomas G. Krattenmaker, *Telecommunications Law and Policy* 516 (1994).

the demand for local telephone service remained relatively inelastic, petitioners' loss, if any, from AT&T's acquisition of monopoly power could be small,[16] and could be more than offset by the gain from the regulatory evasion scheme.

Allegations that petitioners specifically intended to assist AT&T in monopolizing the removal services market thus are not so "preposterous" as to warrant dismissal as a matter of law. Pet. Br. 39 (quoting *Car Carriers*, 745 F.2d at 1110). To be sure, summary judgment may ultimately be warranted if the evidence uncovered does not support a reasonable inference that petitioners acted with the specific intent to monopolize. See *Matsushita Elec. Indus. Co* v. *Zenith Radio Corp.*, 475 U.S. 574, 587 (1986); cf. *Hospital Bldg. Co.* v. *Trustees of Rex Hosp.*, 425 U.S. 738, 747 n.5 (1976). But there is no basis for dismissing the complaint, as the court of appeals read it, on the ground that "it is simply not rational economic behavior for a buyer like NYNEX to agree to create market conditions * * * in which it could then be exploited." Pet. Br. 38.

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[16] The parties might have structured the division of profits from the regulatory evasion scheme to compensate petitioners for any loss resulting from AT&T's anticipated acquisition of monopoly power. Cf. Amend. Compl. ¶¶ 31, 59, 110 (J.A. 84, 92, 112-113) (allegations of rebates from AT&T to petitioners). Evidence of such an arrangement, of course, is likely to be "in the hands of the alleged conspirators," a circumstance that has informed this Court's teaching that in antitrust cases "dismissals prior to giving the plaintiff ample opportunity for discovery should be granted very sparingly." *Hospital Bldg. Co.* v. *Trustees of Rex Hosp.*, 425 U.S. 738, 746 (1976) (internal quotation marks omitted).

4. Although the court of appeals correctly held that petitioners, under certain circumstances, could be held liable for conspiring to monopolize the removal services market, we nonetheless believe that the Court should vacate the court of appeals' judgment and remand the Section 2 claim (along with the Section 1 claim, see pp. 19-20, *supra*) for further proceedings. The petition (see Pet. 14) and our discussion here are premised on the understanding that the court of appeals read the complaint to allege that petitioners engaged in a conspiracy with the specific intent to assist AT&T in acquiring monopoly power in the relevant removal services market through improper means. The court's opinion, however, is not completely clear on the point. See, *e.g.*, Pet. App. 15a (finding sufficient allegations that petitioners sought AT&T's "dominance," but not explaining whether "dominance" encompasses monopoly power). And, absent a specific intent to confer monopoly power on AT&T through improper means, a Section 2 claim would not be stated. In these circumstances, we believe that it would be appropriate to remand the case to allow the court of appeals to clarify the basis for its decision and to determine whether the Section 2 claim should proceed.

This disposition is particularly appropriate in light of the court of appeals' reinstatement of the Section 2 claim based on a theory that Discon did not clearly advance. As noted above, petitioners' merits brief in this Court raises a number of objections to the court of appeals' reinstatement of the Section 2 claim that are not fairly included within the question presented in the petition. Because the court of appeals found that the Section 2 claim was sufficiently alleged on a basis "not previously argued," *Trest* v. *Cain*, 118 S.

Ct. 478, 481 (1997), petitioners have not yet had a chance fully to present these arguments to the court of appeals. They should be given that opportunity on remand.

CONCLUSION

The judgment of the court of appeals should be vacated, and the cause remanded for further proceedings.

Respectfully submitted.

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